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In the Supreme Court of the United States

OCTOBER TERM, 1985

PAPAGO TRIBAL UTILITY AUTHORITY, PETITIONER

v.

FEDERAL ENERGY REGULATORY COMMISSION

ON PETITION FOR A WRIT OF CERTIORARI TO THE UNITED STATES COURT OF APPEALS FOR THE NINTH CIRCUIT

MEMORANDUM FOR THE FEDERAL ENERGY REGULATORY COMMISSION IN OPPOSITION

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The question presented here is whether the Federal Energy Regulatory Commission sufficiently reduced an electric utility's rates to its customers to account for the sale by the utility of tax benefits in a "safe harbor lease." The Commission, affirmed by the court of appeals (Pet. App. 17a), measured the reduction by the proceeds of the sale; petitioner contends that the transaction was imprudent and urges that rates be further lowered.

1. a. The regulatory background and the relevant facts are detailed in the opinion of the court of appeals (see Pet. App. 10a-11a, 15a). Section 201(a) of the Economic Recovery Tax Act of 1981 (ERTA), 26 U.S.C. 168(f)(8), which was repealed in 1982, permitted companies to transfer certain tax benefits to other entities in exchange for cash. This transaction was called a "safe harbor lease." The Arizona Public Service Company (APS), a public utility, took

advantage of that provision and in 1981 sold the tax benefits arising out of the construction of a nuclear plant to the General Electric Company for slightly more than $50 million. Because "taxes are one element of [a utility's rates]" and "ratepayers are being charged for * * * tax costs, the ratepayers receive [in lower rates] the tax benefits associated with" deductions and credits (Pet. App. 11a-12a (citation omitted)). Therefore, when APS consummated its safe harbor lease it owed some compensation to its ratepayers for the loss of the financial advantage they would have derived from APS's tax benefits.

b. An Administrative Law Judge (ALJ) of the Commission held a hearing to determine the appropriate amount of relief APS owed its customers and the proper means of providing it. In his Initial Decision (Pet. App. 39a-68a) the ALJ held that APS must spread the $50 million as a "reduction of the tax expense * * * over the service life of the plant, with the unamortized balance being deducted from the utility's rate base" (Pet. App. 63a). He rejected petitioner's argument (as the representative of customer interests) that the utility should reduce its rates by a greater sum. The ALJ acknowledged (Pet. App. 54a) that, as a result of the sale, ratepayers will incur in higher rates more than double the proceeds APS realized from it.[1] However, the ALJ also found (Pet. App. 55a) that APS acted prudently in engaging in the safe harbor lease, and he therefore held that there was no reason to punish the utility by granting rate reductions of

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[1]By engaging in the transaction, the utility gave up $47 million in tax credits, thereby increasing its future tax liability by $47 million (Pet. App. 56a). Under cost-of-service ratemaking, a utility is entitled to reimbursement of its tax expense in its projected earnings. However, because a utility must pay taxes on the funds it earns from ratepayers, it takes approximately $1.95 in additional rate payments to provide the utility with additional after-tax earnings of $1.00. See *id.* at 52a.

a size greater than the amount APS realized from the transaction. The ALJ stated (*ibid.* (footnote omitted)):

> The evidence conclusively shows that the negotiations * * * took place at arm's length. The weight of the evidence also shows that APS secured about the best price it could have expected for its tax benefits, given the then-current market * * * [and] the rather brief period of time the law provided for a safe harbor sale of [this type].

Finally, the ALJ pointed out that, although the safe harbor transaction cost the ratepayers much more than the $50 million paid by General Electric, the value of the tax benefits to APS, if it had retained them, was less than $50 million (*id.* at 56a). See generally Pet. App. 12a.

The Commission affirmed on this issue (Pet. App. 27a-36a), substantially for the reasons stated by the ALJ, and denied rehearing (*id.* at 19a-25a). The court of appeals affirmed (*id.* at 1a-18a). The court specifically "decline[d] to disturb the ALJ's exercise of his sound discretion" in finding that the transaction was a prudent business decision and therefore that it was not appropriate to make the rate adjustment equal to the full value of the tax benefits to the ratepayers (*id.* at 17a).

2. Petitioner contends (Pet. 10-14) that the court of appeals erred in affirming the Commission's treatment of the tax transaction for ratemaking purposes. At the outset, we note that, whether or not this is so, it is apparent that the issue presented here is of no continuing importance because the safe harbor leasing provision was repealed after it had been in effect for one year. Thus, as petitioner acknowledges (Pet. 7 n.3), the "fact situation involved herein is unlikely to recur." In any event, the court of appeals correctly affirmed the Commission's decision, and there is no reason for further review by this Court.

Petitioner does not take issue with the ALJ's statement that "Congress did not in ERTA mandate or prohibit any specific treatment of safe harbor proceeds in the hands of regulated public utilities" (Pet. App. 64a). It is well established that the Commission may adopt any of a variety of methods of treating these transactions for ratemaking purposes, as long as the method selected is not demonstrably at odds with the statutory scheme of regulation. See, *e.g.*, *FPC* v. *United Gas Pipe Line Co.*, 386 U.S. 237, 246 (1967); *Colorado Interstate Gas Co.* v. *FPC*, 324 U.S. 581, 589 (1945). Here, the ALJ, recognizing the "unevenness of the bargain" as between the interests of ratepayers and shareholders (see Pet. App. 63a) determined that the ratepayers should receive the benefits and suffer the burdens of an otherwise prudent transaction, even if from their point of view the latter are greater than the former. This resolution, which represented a middle ground between the claims of the two sides, lay well within the agency's discretion.

The thrust of petitioner's contention appears to be to dispute the Commission's finding that APS acted "prudently" in selling its tax benefits. Petitioner characterizes the decision below as holding "that any lawful cost incurred by a utility is *per se* prudent" (Pet. 12). This is plainly not what the court held. The Commission's decision did not rest solely on the lawfulness of the transaction. The ALJ examined the transaction in some detail and concluded that it was an arm's-length transaction in which APS received the fair market value for its tax benefits and that the sale price exceeded the value of the benefits to the utility (Pet. App. 55a-56a). In the absence of any showing that the law requires a utility "to act in the best interests of its ratepayers in circumstances where those interests conflict with the

corporate interests of the utility and its stockholders" (*id.* at 56a), the ALJ concluded that the transaction could not be considered imprudent.[2] That conclusion was correctly affirmed by the Commission and the court of appeals, and petitioner presents no sound basis for disputing it.[3]

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[2]Petitioner's reliance on *Cities Service Gas Co.* v. *FPC*, 424 F.2d 411 (10th Cir. 1969), cert. dismissed, 400 U.S. 801 (1970), is misplaced. There, the court found that failure to make the adjustment sought by the ratepayers would result in a "windfall" for the utility (424 F.2d at 417). That is plainly not the case here where the full proceeds of the sale formed the basis for the rate adjustment.

[3]Petitioner's assertion (Pet. 7-10) that the decision below violates the principles of *SEC* v. *Chenery Corp.*, 318 U.S. 80 (1943), is wholly without merit. The court of appeals did not affirm on a basis different from that relied upon by the agency. On the contrary, the court of appeals expressly relied on the Commission's reasoning, noting that petitioner was "unable to overcome the ALJ's finding that the transaction was not imprudent" and therefore that it would "decline to disturb the ALJ's exercise of his sound discretion in concluding that APS acted prudently" (Pet. App. 17a). The court of appeals did not reject any aspect of the Commission's or the ALJ's reasoning. It is true, of course, that the Commission had rejected APS's argument that *no* rate adjustment should be made because these transactions were encouraged by Congress, but the court of appeals' statement that the fact that the transaction was lawful and encouraged by Congress was relevant to the question whether it was prudent is not at all inconsistent with the Commission's view. The assertion that the statement made by the court of appeals was rejected by the Commission is fanciful.

It is therefore respectfully submitted that the petition for a writ of certiorari should be denied.

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